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IN THE

Supreme Court of the United States

OCTOBER TERM, 1948

No. 288

LEWIS L. STRAUSS,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF

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September 16, 1948.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

Your petitioner, Lewis L. Strauss, respectfully prays that a writ of certiorari be issued to review an order, judgment and decree of the United States Circuit Court of Appeals for the Second Circuit (now the United States Court of Appeals for the Second Circuit) entered June 4, 1948 (petition for rehearing filed June 18, 1948 and denied June 22, 1948) reversing the decision of the Tax Court, entered on July 11, 1947. A certified transcript of the record is furnished herewith in accordance with Rule 38, Par. 1, of the Rules of this Court.

Statement

The Commissioner of Internal Revenue determined deficiencies in the petitioner's income tax for the years 1938 and 1939 by including in the petitioner's income royalties paid upon an interest in the Kodachrome process of manufacturing color film, which royalties were reported by the petitioner's wife in her income tax returns for those years (R. 12, 41).

It was alleged in the petition filed in the Tax Court and admitted in the Commissioner's answer thereto and found by the Tax Court as a fact that "In 1935, the petitioner was the owner of an interest in the Kodachrome process of manufacturing color film" (R. 6, 15, 19).

It was stipulated by the parties that:

> "Prior to 1935, the petitioner rendered services to the New York and Foreign Development Corporation, a corporation formerly existing under the laws of the State of New York, in connection with the financing of a process known as 'Kodachrome' used in the manufacture of color film. For the rendition of said services, petitioner was entitled to receive a certain percentage of the royalties on said process. All royalties on such process (except certain flat royalties payable directly to the inventors and which are not here in question) were, pursuant to an assignment, dated November 1, 1930, by Messrs. Mannes and Godowsky, the inventors of such process, payable by the Eastman Kodak Company to Messrs. Kuhn, Loeb & Co., as Trustees. Kuhn, Loeb & Co. thereupon paid such royalties to those entitled to receive them." (R. 40).

In 1935 the petitioner assigned, absolutely and irrevocably, all his right, title and interest in the Kodachrome

process to his wife, the assignment being evidenced by a letter dated December 20, 1935, and notified Kuhn, Loeb & Co. of the assignment (R. 19, 20).

During 1938, the petitioner's wife received from Kuhn, Loeb & Co., pursuant to the assignment, $10,209.50 in royalties paid on the Kodachrome process, and during 1939 the petitioner's wife received $14,183.94 in such royalties (R. 41). It was alleged in the petition and admitted in the respondent's answer that such amounts were "royalties paid upon said interest in the Kodachrome process" (R. 6, 7, 15). All such royalties were paid for periods after 1935. The petitioner's wife included such amounts in her Federal income tax returns for the years 1938 and 1939 and paid income tax thereon (R. 41).

The Tax Court expunged the deficiencies in the petitioner's tax, as determined by the Commissioner, in so far as such royalties were concerned. In support of its decision, the Tax Court found:*

> "Aside from respondent's admission that petitioner owned an interest in the Kodachrome process, we think it clearly appears from the facts herein that petitioner acquired ownership of such interest in consideration for and in full payment of his services to New York and Foreign Development Corporation" (R. 28).

The Tax Court also found:*

> "In the instant case petitioner earned compensation for services rendered to New York and For-

*Statements made by the Tax Court in its opinion are properly considered as findings of fact. *Insurance & Title Guarantee Co.* v. *Commissioner*, 36 F. (2d) 842 (C. C. A. 2nd, 1929), cert. denied, 281 U. S. 748 (1930); *Baker* v. *Commissioner*, 115 F. (2d) 987 (C. C. A. 6th, 1940).

> eign Development Corporation, for which he was paid by the vesting in him of ownership of an interest in the Kodachrome process. This process was an income-producing asset and produced income in the form of royalties. Such royalties were not the earnings of petitioner and were not compensation for services rendered by petitioner. They were the increment of an investment in income-producing property. He assigned this property to his wife and she as the owner thereof received the royalties in question in the taxable years here involved by reason of her ownership of the property from which the royalties flowed" (R. 31).

On appeal, the Circuit Court of Appeals for the Second Circuit reversed the Tax Court (R. 73). Although the Circuit Court of Appeals did not in terms make new findings of fact, in effect it did so, for its opinion could not possibly have been reached nor could it stand on the basis of the facts found by the Tax Court. The Circuit Court of Appeals said that the petitioner had a "right to receive part of the royalties paid by the Eastman Kodak Company" (R. 64). The Circuit Court of Appeals also said that the petitioner did not receive for the services he rendered to New York and Foreign Development Corporation "any part of the Kodachrome process itself or any right to control the disposition of that process" (R. 65). There was no evidence in the record before that Court to indicate whether the petitioner had or had not any right to control the disposition of that process. The Circuit Court of Appeals further said:

> "* * * Rather, he obtained the enforceable promise of the owners of the process that he would be paid for his services a definite portion of the royalties

they had the right to receive from the Eastman Kodak Company" (R. 65).

The Circuit Court of Appeals concluded:

"* * * This taxpayer's right to receive royalties, we think, is indistinguishable from the right, which was considered in *Helvering* v. *Eubank* [311 U. S. 122 (1940)] * * *" (R. 65).

Jurisdiction

Jurisdiction of this Court is invoked under the Judicial Code, § 240 (a), as amended by the Act of February 13, 1925 (43 Stat. 938, 28 U. S. C. § 347 (a)), and alternatively under Title 28, United States Code, Section 1254(1), effective September 1, 1948 (Public Law 773, Act of June 25, 1948, 62 Stat. —). The date of the order, judgment and decree of the Circuit Court of Appeals for the Second Circuit to be reviewed was June 4, 1948, and a timely filed petition for rehearing was denied by that Court on June 22, 1948.*

Question Presented

The question presented is threefold:

(1) Was the finding of the Tax Court that the petitioner owned and assigned to his wife a property interest in the Kodachrome process, an income-producing asset, supported by substantial evidence and therefore a conclusive finding of fact which could not be reviewed by the

*The decision of the Court below also involved an affirmance of the decision of the Tax Court on an unrelated issue (the Polaroid Issue) as to which this petition for certiorari is not directed.

Circuit Court of Appeals and supplanted with an independent finding that the petitioner did not own any part of the Kodachrome process itself or any right to control the disposition of that process?

(2) Should the Circuit Court of Appeals have remanded the case to the Tax Court for a finding of fact on the precise nature of the interest in the Kodachrome process which the petitioner owned and assigned to his wife, once it determined that the Tax Court's original finding was not supported by the record?

(3) If the finding of the Circuit Court of Appeals was proper, should not that Court have determined, on the basis of its own finding, that the owners of the process turned over to the petitioner, in full satisfaction of his right to receive compensation for his past services, the right to receive (itself a property right) a definite portion of the royalties which such owners had the right to receive from Eastman Kodak Company, and that, therefore, the petitioner was not taxable, after the assignment in 1935 to his wife of what he then owned, on the amounts which she received, pursuant to that assignment, in 1938 and 1939?

Reasons Relied Upon for Allowance of the Writ

1. The Circuit Court of Appeals, in reversing the Tax Court's decision, rather than affirming it, or, in the alternative, remanding the cause, disregarded a conclusive finding of fact of the Tax Court, substituting therefor its own very different finding of fact, and so far departed from the accepted and usual course of judicial proceedings set by this Court for review of decisions of the Tax Court as to call for an exercise of this Court's power of supervision.

2. The Circuit Court of Appeals, even accepting its own construction of the facts, has rendered a decision in conflict with a decision of the Third Circuit Court of Appeals on the same matter, viz., the extent to which a taxpayer remains taxable on royalties paid to his wife pursuant to an assignment to her by the taxpayer of a right to a certain portion of the royalties from an invention. *Nelson* v. *Ferguson*, 56 F. (2d) 121 (C. C. A. 3rd, 1932), cert. den., 286 U. S. 565 (1932).

3. The Circuit Court of Appeals, even accepting its own construction of the facts, has decided a Federal question in a way in conflict with decisions of this Court, since it has improperly extended the principle of *Helvering* v. *Eubank*, 311 U. S. 122 (1940), so that it is in conflict with the principle of *Blair* v. *Commissioner*, 300 U. S. 5 (1937), and *Commissioner* v. *Sunnen*, 333 U. S. 591 (1948).

4. The Circuit Court of Appeals has decided an important question of Federal law which has not been, but should be, settled by this Court. Under the decision of the Circuit Court of Appeals, taxpayers throughout the United States are placed in a position of doubt as to whether a taxpayer may ever gratuitously assign an interest in property which he has received as compensation for services in a way which will shift to his assignee tax liability on income thereafter received. This Court should settle the question of whether, and to what extent, a taxpayer may be taxed on income irrevocably belonging to another following an assignment of property received by the taxpayer as compensation for services.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of

this Court, directed to the United States Court of Appeals for the Second Judicial Circuit, sitting at New York, New York, commanding said Court to certify and send up to this Court, on a date to be designated, a full and complete transcript of the record and of all proceedings in the Circuit Court of Appeals had in this case, to the end that this case may be reviewed and determined by this Court; that the order, judgment and decree of the Circuit Court of Appeals be reversed; and that your petitioner be granted such other and further relief as may seem proper.

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BRIEF IN SUPPORT OF PETITION

Opinions Below

The opinion of the Tax Court (R. 17-37) is reported at 8 T. C. 1058. The opinion of the Circuit Court of Appeals (R. 62-72) is reported at 168 F. (2d) 441.

ARGUMENT

1. THE CIRCUIT COURT OF APPEALS IMPROPERLY SUBSTITUTED FOR THE TAX COURT'S FINDING OF FACT ITS OWN FINDING OF FACT.

The taxability of the Kodachrome royalties to the petitioner or to the petitioner's wife, who received them, depends upon an essential preliminary determination of the facts: What did the petitioner own and assign to his wife?

In the pleadings before the Tax Court the parties treated that question as one which was not in issue. The petitioner had alleged, and the respondent had admitted, that the petitioner in 1935 was the owner of an interest in the Kodachrome process of manufacturing color film, and that the amounts which were paid to the petitioner's wife in 1938 and 1939 were royalties upon such interest in the Kodachrome process. Being the owner of an interest, the petitioner was entitled, as the parties stipulated, to receive a certain percentage of the royalties on the Kodachrome process. In 1935 the petitioner assigned to his wife all his right, title and interest in Kodachrome, including the right to receive the royalties on the Kodachrome process.

Because the pleadings and the stipulations of fact disposed of the question, the petitioner introduced no evidence

before the Tax Court to support his ownership of an interest in the Kodachrome process.

Upon that record the Tax Court found, before undertaking consideration of the question whether the petitioner was taxable on the royalties paid to his wife subsequent to the assignment to her, that the petitioner owned, and assigned to his wife, a property interest in the Kodachrome process entitling him to a certain percentage of the royalties on such process.

The Circuit Court of Appeals, reversing the findings of the Tax Court, found that the petitioner did not own, prior to the assignment to his wife, any part of the Kodachrome process itself or any right to control the disposition of that process, but, rather, that he merely had the enforceable promise of the owners of the process that he would be paid for his services a definite portion of the royalties they had a right to receive from the Eastman Kodak Company. The record is clear that the royalties in question were paid to the petitioner's wife by Eastman Kodak Company through Kuhn, Loeb & Co., as Trustees (R. 18, 40).

It may be admitted that, as an original proposition, the petitioner might have owned (1) an undivided interest in the Kodachrome process (as found by the Tax Court) or (2) an undivided interest in the Eastman Kodak Company royalty contract, i.e., the enforceable promise of the owners of the process that the petitioner would be paid (by Eastman) a definite portion of the royalties they had a right to receive from Eastman (as stated by the Circuit Court of Appeals).

It was the function of the Tax Court to determine which of those alternative interests the petitioner had before

the assignment of his rights to his wife, on the basis of the record before that Court, and prior to a determination of the income tax consequences to the petitioner.* In making the finding that the petitioner owned a property interest in the Kodachrome process which entitled him to a percentage of the royalties received from such process, the Tax Court conclusively determined a question of fact, since that finding was fully supported by the pleadings in the record before the Tax Court. Accordingly, the Circuit Court of Appeals could review the Tax Court's decision as to the petitioner's tax liability only on the basis of accepting the Tax Court's finding that the petitioner owned and assigned to his wife an interest in the Kodachrome process. *Commissioner* v. *Scottish American Inv. Co.*, 323 U. S. 119 (1944); *Wilmington Trust Co.* v. *Helvering*, 316 U. S. 164 (1942); *Helvering* v. *Kehoe*, 309 U. S. 277 (1940); *Helvering* v. *F. & R. Lazarus & Co.*, 308 U. S. 252 (1939).

Indeed, the error of the Circuit Court of Appeals goes beyond its unwarranted review of a conclusive finding of the Tax Court. The Circuit Court of Appeals substituted a finding of its own which is unsupported by anything in the record. There was nothing in the record before that Court to indicate whether the petitioner had or had not any

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*In *Helvering* v. *F. & R. Lazarus & Co. Inc.*, 308 U. S. 252 (1939), this Court held that the question of whether a transaction was a sale or mortgage was a question of fact, conclusively determined by the Tax Court if supported by substantial evidence; and in *Choate* v. *Commissioner*, 324 U. S. 1 (1945), this Court held similarly with respect to whether a transaction was a sale or a lease.

right to control the disposition of the Kodachrome process nor was there anything in the record to indicate, contrary to the pleadings, that, rather than an interest in the process itself, the petitioner had only the enforceable promise of the owners of the process that he would be paid a definite portion of the royalties they had a right to receive.

What the Circuit Court of Appeals failed to note, moreover, was that *on the record presented to the Tax Court*, Lewis L. Strauss, the petitioner herein, was the *only* person in the world who had an interest in the Kodachrome process in 1935, the year he assigned it to Mrs. Strauss. The other "owners of the process", referred to by the Circuit Court of Appeals, if any, are not named. Presumably, New York and Foreign Development Corporation, which had financed the Kodachrome process, at one time owned a part of it. Presumably, also, Messrs. Mannes and Godowsky, the inventors of that process, at one time owned a part of it. However, on the record before the Tax Court, the only possible finding of ownership of the process, without speculation on facts outside the record, was that the petitioner owned an interest in the Kodachrome process in 1935, prior to the assignment to his wife. It was only by presuming facts outside the record that the Circuit Court of Appeals could find that other unnamed owners of the process merely gave the petitioner a promise that he would be paid by Eastman a part of their royalties.

2. IF THE CIRCUIT COURT OF APPEALS WISHED TO REJECT THE TAX COURT'S FINDING, IT SHOULD HAVE REMANDED THE CAUSE.

If the Circuit Court of Appeals was dissatisfied with the finding of the Tax Court on the ground that it was not substantially supported by the record, then the record was inadequate for a final decision of the legal question involved and the proper action of the appellate Court should have been to remand the cause to the Tax Court. *Helvering* v. *Rankin,* 295 U. S. 123 (1935); *Helvering* v. *Taylor,* 293 U. S. 507 (1935). The action taken by the Circuit Court of Appeals in making its own finding contrary to the pleadings and to the Tax Court's finding was highly prejudicial to the petitioner. On the pleadings, the question of whether he owned an interest in the Kodachrome process, or owned something else, was not in issue. By disregarding the admissions of the pleadings, and making a contrary finding of fact, the Circuit Court of Appeals has effectively denied to the petitioner a proper opportunity to present detailed evidence in support of the pleadings to establish the fact that he had a property interest in the Kodachrome process, as distinguished from the enforceable promise of the owners of the process that he would be paid a definite portion of the royalties they were entitled to receive. The appellate Court having concluded for some reason that the admissions of the pleadings, and the findings of the Tax Court were wrong, it should have remanded the cause to the Tax Court with instructions to receive further evidence and to make new findings of fact on the precise nature of the property interest that the petitioner owned and assigned to his wife.

3. THE DECISION BELOW IS IN CONFLICT WITH THE DECISION OF THE THIRD CIRCUIT COURT OF APPEALS IN *NELSON* V. *FERGUSON*.

In *Nelson* v. *Ferguson*, 56 F. (2d) 121 (C. C. A. 3d, 1932) cert. den., 286 U. S. 565 (1932), the taxpayer, while in the service of his employer, obtained a patent on an invention having to do with the business of his employer. He assigned the patent to his employer in return for one-third of the net profit realized from the invention. Thereafter, the taxpayer assigned to his wife his rights to the profits from the invention. The Third Circuit Court of Appeals held that the contractual promise of the taxpayer's employer to pay one-third of the profits from the invention, which the taxpayer assigned to his wife, was a property right and, accordingly, the taxpayer was no longer taxable on the profits paid to his wife after the assignment.

In the instant case the Circuit Court of Appeals found that the petitioner had the contractual promise of the owners of the process that he would be paid a definite portion of the royalties from the process, but held that the assignment of that contractual promise to his wife did *not* relieve him of tax liability on the royalties paid to his wife.

There is, therefore, a clear conflict between the two Circuit Courts of Appeals as to whether a contractual right to a portion of the royalties or profits from an invention is income-producing property which, when completely and irrevocably assigned, shifts the income tax liability to the assignee.

4. THE DECISION BELOW IMPROPERLY APPLIES THE PRINCIPLES LAID DOWN BY THIS COURT IN PREVIOUS CASES.

In support of the decision below, the Circuit Court of Appeals cited its belief that the instant case was indistinguishable from *Helvering* v. *Eubank,* 311 U. S. 122 (1940), and was, therefore, controlled by the decision of this Court in that case.

The instant case is not at all like the *Eubank* case. That is clearly so if the Tax Court's finding that the petitioner owned and assigned to his wife a property interest in the Kodachrome process was conclusive. It is so even if the Circuit Court of Appeals acted properly in finding that the taxpayer received the enforceable promise (itself a property interest) of the owners of the process that he would be paid a definite portion of the royalties payable by the Eastman Kodak Company.

In the *Eubank* case the taxpayer assigned to a corporate trustee the contractual obligation of his *employer* to pay him renewal commissions, on premiums to be paid by the policyholders in the future, which commissions the taxpayer had earned as an insurance agent. The payments which were later made by the employer, pursuant to his contractual obligation to the employee, directly to the trustee were held to be taxable to the taxpayer-employee. The payments retained their character as compensation. They were made by the employer in discharge of its contractual obligation *to compensate* the employee.

In other words, in the instant case even the Circuit Court of Appeals admits that the petitioner had a "right to receive royalties" paid by the Eastman Kodak Company (R. 65).

In the *Eubank* case the taxpayer did not have a right to receive premiums paid by the policyholders to his employer. He merely had a right to receive "commissions" measured by the amount of premiums which might be paid, i.e., a right to receive compensation. As this Court said in the *Eubank* case (p. 125):

> "No purpose of the assignments appears other than to confer on the assignees the power to collect the commissions, which they did in the taxable year. The Government and respondent have briefed and argued the case here on the assumption that the assignments were voluntary transfers to the assignees of the right to collect the commissions as and when they became payable, and the record affords no other basis."

In the instant case the Circuit Court of Appeals found that the petitioner obtained the enforceable promise of the owners of the process that he would be paid for his services (rendered to New York and Foreign Development Corporation) a definite portion of the royalties the owners had a right to receive from the Eastman Kodak Company (R. 65) and recognized that in 1935 the petitioner had a right to receive part of the royalties paid by the Eastman Kodak Company (R. 64). That Court must therefore have regarded the enforceable promise of the owners of the process as having been executed by the assignment to the petitioner of a part of the Eastman contract to pay royalties. Accordingly, unlike the *Eubank* case where the right assigned by the taxpayer was the promise of his employer to pay commissions, in the instant case the assigned right was the right to receive part of the royalties paid by the Eastman Kodak Company. Therefore, even on the view of the facts taken by the Circuit Court of Appeals,

the assigned promise was that of Eastman and not that of the employer, and what the petitioner obtained (and assigned to his wife) was part of an income-producing contract. He did *not* assign to his wife recurrent compensation payments made by his employer, which were the subject of the assignment in the *Eubank* case.

The employer in the instant case discharged its obligation to pay the petitioner for his services by giving him the right to receive a portion of the royalties that were payable by Eastman. The petitioner's compensation was the receipt of that right, not the payments thereafter made (by one other than the employer) pursuant thereto. In the *Eubank* case, the obligation of the employer to pay compensation was continuing and was discharged only as the employer made the payments pursuant to its contractual obligation.

A tabular comparison of the *Eubank* case with the instant case shows the complete dissimilarity of the two:

	The Eubank Case	**The Instant Case**
Services rendered to:	Insurance company.	New York and Foreign Development Corporation.
When payment of compensation made:	In current taxable year.	Not in current taxable year, but in the year 1935 or earlier.
Payment sought to be taxed made by:	Employer.	Eastman Kodak Company through Kuhn, Loeb & Co., trustee (neither was the employer).
Payment sought to be taxed made as:	Commissions for services.	Royalty on an assigned property interest.
Employer's obligation to pay compensation:	Continuing.	Discharged in 1935, or earlier.

In other words, even on the theory of the Circuit Court of Appeals, the petitioner received as compensation an as-

signment by his employer of a promise of a third party, which assignment discharged the obligation of his employer to pay him compensation. The payments made pursuant to that assignment were not made as compensation for services but by the Eastman Kodak Company as royalties, all obligation to pay compensation having been discharged in 1935 or earlier. The right which the petitioner had to receive his portion of those royalties from Eastman was itself a property right which, when in turn assigned completely and irrevocably by the petitioner to his wife, relieved him, under the decision of this Court in *Blair* v. *Commissioner*, 300 U. S. 5 (1937), of further income tax liability on income arising from that right.

Moreover, the Circuit Court of Appeals, in deciding the instant case, completely ignored the rules recently laid down by this Court in *Commissioner* v. *Sunnen*, 333 U. S. 591 (1948), where this Court granted certiorari in order to decide questions of importance in administering the Internal Revenue laws. In that case, this Court said (at p. 604) that in determining who is taxable after a transfer of income-producing property (a royalty contract) the crucial question is:

> "* * * whether the assignor retains sufficient power and control over the assigned property or over the receipt of the income to make it reasonable to treat him as the recipient of the income for tax purposes."

As is clear from the record in this case, the petitioner did not retain any control over either the assigned property or the receipt of the income after his complete and irrevocable assignment to Mrs. Strauss in 1935.

5. THE DECISION BELOW INVOLVES AN IMPORTANT QUESTION OF FEDERAL LAW WHICH HAS NOT BEEN SETTLED BY THIS COURT.

Under the decision of the Circuit Court of Appeals, taxpayers throughout the United States are placed in a position of doubt as to whether a taxpayer may ever gratuitously assign a right which he has received as compensation for services without remaining taxable on the income from that right received by his assignee. Because of the drastic effect of holding a taxpayer liable for the tax on income which he cannot receive or obtain, because it irrevocably belongs to another, the principles under which such a result is reached should be defined as clearly as possible for the guidance of the many taxpayers affected.

No court has held, to our knowledge, before the decision in the instant case, that the promise of a third party, other than the employer, received in discharge of the obligation of the employer to pay compensation, can not be assigned gratuitously by the taxpayer so as to make the assignee the owner, and thus responsible for the tax on any income received. Nor has any court held that an interest in an invention received as compensation for services cannot be so assigned. The implications of the decision of the Circuit Court of Appeals are manifold and that Court did not articulate any standards for guidance as to the extent of the implications of its decision.

If the principle that a taxpayer may be taxed on income irrevocably belonging to another is to be extended to the broad field of the assignment of property received as compensation for services, we respectfully submit that the application of that principle in such circumstances should be settled as the result only of a decision of this Court.

Conclusion

The cases in which an individual is taxable on income which he does not and cannot receive are very few, and for the most part are governed by specific provisions in the Internal Revenue Code. The hardship upon the taxable individual in such a case is great. Additional cases should not be added to this exceptional category, therefore, unless the plain language of the statute requires it.

The decisions of this Court, as well as the long history of the Code, point the other way in this case. No proposition is better established than that income from property is taxable to the owner of such property. The pleadings and the Tax Court's findings of fact established that Mrs. Strauss and not the petitioner was the owner of the interest in the Kodachrome process which produced the income here involved. Consequently, the income was taxable to her, not to the petitioner.

It is submitted, therefore, that this Court should issue a writ of certiorari to review the erroneous decision of the Circuit Court of Appeals in this case.

Respectfully submitted,

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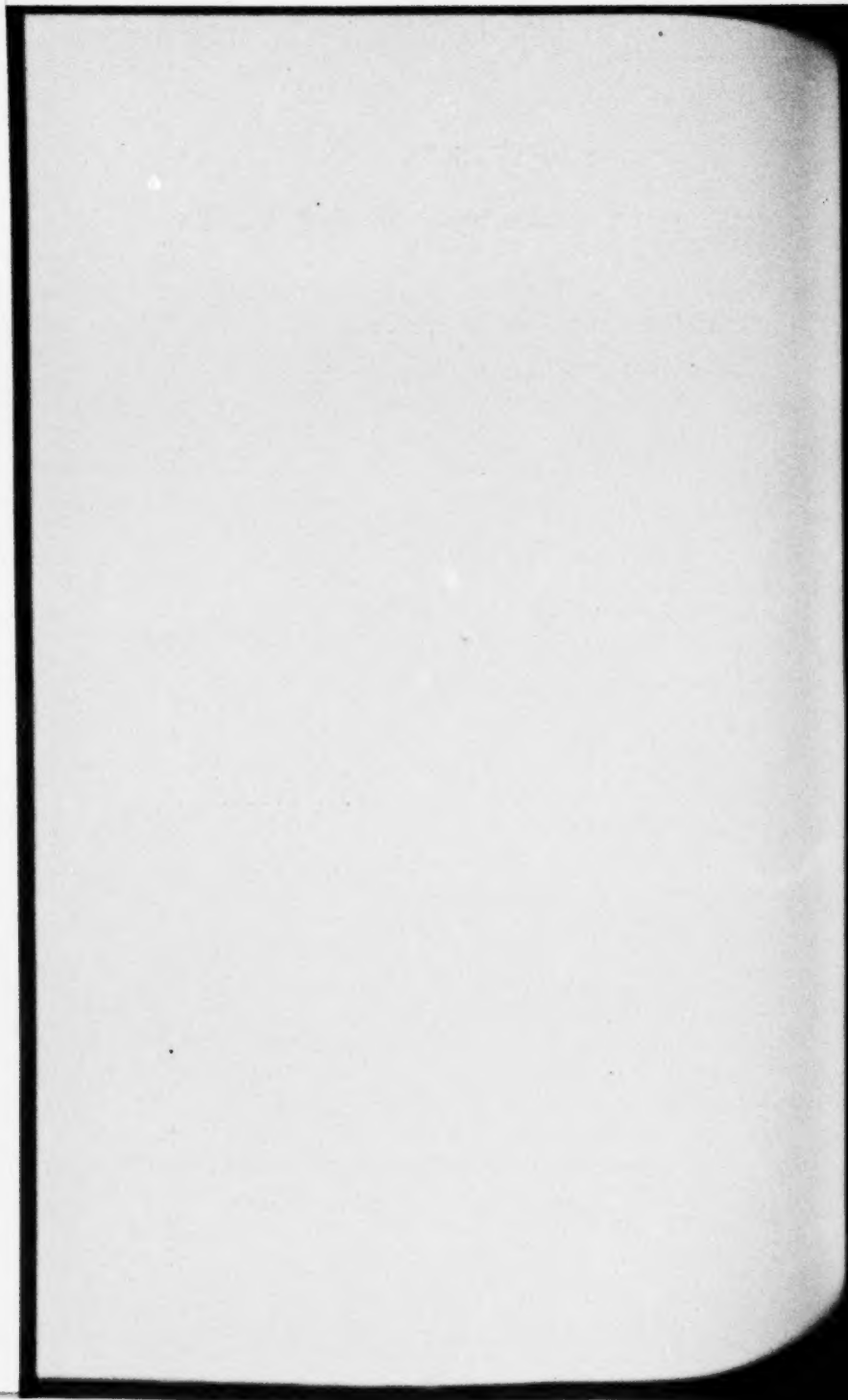

IN THE

Supreme Court of the United States

OCTOBER TERM, 1948

LEWIS L. STRAUSS,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

No. 288

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF IN SUPPORT OF THE PETITION

1. The Findings of the Tax Court on the Basic Factual Issue Are Conclusive.

The brief for the respondent in opposition to the petition for certiorari does not attempt to meet the basic issue in this case other than to call it a "technical" one (Br. 10). That basic issue is the factual one of whether the petitioner's compensation was (1) the receipt by him of an "interest in the Kodachrome process of manufacturing color film", i.e. an interest in an invention, or (2) the receipt of a percentage of the royalties paid upon that interest.

That basic factual issue was decided adversely to the respondent by the Tax Court when it found that "the petitioner was the owner of an interest in the Kodachrome process" (R. 19);* and that the "petitioner acquired ownership of such interest in consideration for and in full payment of his services to New York and Foreign Development Corporation" (R. 28). The Tax Court further found that the petitioner was paid for his services "by the vesting in him of ownership of an interest in the Kodachrome process" and that the royalties paid upon that interest, which was "an income-producing asset", were "not compensation for services rendered by petitioner" (R. 31).

The Court of Appeals for the Second Circuit made a different determination of that basic factual question and stated that the petitioner was "paid for his services a definite portion of the royalties" (R. 64), thereby reversing the Tax Court upon its determination of the basic factual question in the case. The statement by the respondent (Br. 5) that the Court of Appeals merely disregarded "the label attached by the Tax Court" is both unfair and misleading. Nor is the distinction merely a "technical" one. It is the basic issue in the case. If the receipt of the interest in the Kodachrome process was itself the petitioner's compensation (rather than the royalties to be received thereon) then the assignment of that interest to the petitioner's wife was not the assignment of compensation to be received in the

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*We repeat what we said in our opening brief (p. 12) that *on the record in this case* the petitioner was the only person who had "an interest in the Kodachrome process" (the invention) in 1935. Others may have had interests in the royalties, as the respondent states (Br. 7n), but the petitioner is the only person who was admittedly the owner of an interest in the invention itself at that time.

future, with which this Court was concerned in *Lucas* v. *Earl*, 281 U. S. 111, and *Helvering* v. *Eubank*, 311 U. S. 122, but merely the assignment of an interest *already received as compensation.*

Moreover, the very finding of fact which the Tax Court made in this case was considered basic by this Court in *Commissioner* v. *Smith*, 324 U. S. 177, 695, cited by the respondent (Br. 10). In that case, an employer had given an employee an option to purchase stock at the market value of such stock at the time the option was given in what was admittedly a compensatory arrangement. The employee later exercised the option and at that time the employer transferred to him stock which was worth much more than the price which the employee paid for it. If the receipt of the option itself was considered to be the receipt of compensation, then the employee would not have been taxable, as the year in which the option was received was not before the Court. If, however, the compensation was intended to take place only when the employee exercised the option and received property worth more than he paid for it, the employee would be taxable upon a large amount of income. As this Court said (p. 182), the Tax Court found "that the compensation referred to was the excess in value of the shares of stock over the option price whenever the option was exercised".* Indeed, it would have been difficult in that case for the Tax Court to have found otherwise. The employer obviously did not discharge its obligation to the

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*This Court again emphasized the above finding of the Tax Court in its opinion on rehearing (324 U. S. 695), saying:

> "The Tax Court found that respondent received compensation 'when [he] exercised his option and received the stock'. * * * This conclusion of the Tax Court finds ample support in the record and we concur in it."

employee by merely giving him the option; it could discharge its obligation only by delivering the stock to him at some later date when the option was exercised.

So also in *Helvering* v. *Eubank,* 311 U. S. 122, *supra,* it was not found by the Tax Court, nor could it have been found, that the employer paid the employee compensation by merely giving him a contract to pay him future commissions. The employer's obligation was discharged and the employee received compensation only as the employer paid the commissions pursuant to that contract.

In the instant case, however, the Tax Court has found that the petitioner received his compensation prior to the years here in question (1938 and 1939) by being given "an interest in the Kodachrome process of manufacturing color film". The Tax Court has found explicitly that it was the vesting in the petitioner of that interest (a valuable attribute of which was of course the *right to receive* royalties) which was the compensation for the petitioner's services, and not the royalties themselves.

The record contains ample support for the Tax Court's findings. It was not stipulated that the petitioner's interest in the Kodachrome process consisted "only" of his right to receive royalties, although the respondent's brief contains that implication (Br. 2, 6, 8), and the Tax Court certainly did not so find. Neither is it stipulated that the royalties were the petitioner's compensation, but rather that his compensation was being "*entitled* to receive" such royalties (R. 40). The Tax Court's finding that he was "entitled to receive" such royalties by reason of having been given "an interest in the Kodachrome process" is the only reasonable finding that could be made in view of the admissions on the pleadings that the petitioner was the owner of an "interest

in the Kodachrome process" (R. 6, 15) and that the royalties received by his wife were "royalties paid upon said interest in the Kodachrome process" (R. 6-7, 15).*

The Court of Appeals states in its opinion, however, that it "now appears that the 'interest' was only the right to receive a percentage of the royalties" (R. 63). The Court's use of the word "now" clearly shows that it was substituting its finding for that of the Tax Court. Even if the finding of the Court of Appeals were as reasonable an inference from the record as that of the Tax Court (which it clearly was not) it would still be improper and an abuse of its power of appellate review. The Court of Appeals, by so substituting its own finding of fact for that of the Tax Court, disregarded the rule of appellate review so clearly laid down by this Court in *Commissioner* v. *Scottish American Investment Co. Ltd.*, 323 U. S. 119, 123-124:

> "* * * The Tax Court has the primary function of finding the facts in tax disputes, weighing the evidence, and choosing from among conflicting factual inferences and conclusions those which it considers most reasonable. The Circuit Courts of Appeal have no power to change or add to those findings of fact or to reweigh the evidence. And when the Tax Court's factual inferences and con-

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*The respondent (Br. 7) apparently attributes great weight to the fact that the petitioner notified Kuhn, Loeb & Co. (the trustees to whom the *royalties payable* by Eastman on the Kodachrome process had been assigned by the inventors in 1930) of the assignment of his interest to his wife. As the trustees paid out *all* the percentage royalties on the process (R. 40), any owner of an interest in the invention who assigned his interest to another would necessarily have to notify the trustees so that the assignee of his interest could receive the royalties to which the ownership of that interest entitled him.

> clusions are determinative of compliance with statutory requirements, the appellate courts are limited to a determination of whether they have any substantial basis in the evidence. The judicial eye must not in the first instance rove about searching for evidence to support other conflicting inferences and conclusions which the judges or the litigants may consider more reasonable or desirable. It must be cast directly and primarily upon the evidence in support of those made by the Tax Court. If a substantial basis is lacking the appellate court may then indulge in making its own inferences and conclusions or it may remand the case to the Tax Court for further appropriate proceedings. But if such a basis is present the process of judicial review is at an end. * * *"

That the facts were stipulated or undisputed does not change the rule. As this Court recently said in *Boehm* v. *Commissioner*, 326 U. S. 287, 293:

> "The circumstance that the facts in a particular case may be stipulated or undisputed does not make this issue any less factual in nature. The Tax Court is entitled to draw whatever inferences and conclusions it deems reasonable from such facts."

Nor is the respondent correct in implying (Br. 8) that the petitioner must meet the burden of proving that the Tax Court's finding was the only possible construction of the record. The Tax Court's finding is conclusive if it is supported by substantial evidence, even though the appellate court might also find evidence to support its view (which here it could not). *Helvering* v. *F. & R. Lazarus & Co., Inc.*, 308 U. S. 252; *Choate* v. *Commissioner*, 324 U. S. 1.

The findings of the Tax Court, that (1) it was the giving to the petitioner of his "interest" in the invention (which included the "right to receive" the royalties) which constituted the petitioner's compensation, and (2) that the royalties themselves when later received were not the petitioner's compensation, are amply supported by the pleadings and by the stipulation.*

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*The respondent states (Br. 10-11) that a taxpayer, on the cash basis, who acquires a contract to receive future payments is not taxed when he receives the contract, but only later when he receives the payments. That statement cannot be made seriously, as the respondent has so frequently successfully contended to the contrary.

To take one example, suppose that an employer gives an employee, age 40, an annuity policy under which the employee is to receive payments from an insurance company beginning at age 65. The question is whether the employee's compensation arises from the receipt of the policy or from the receipt of later payments pursuant to the policy. It appears well settled that the compensation arises upon the receipt of the annuity contract. *Oberwinder* v. *Commissioner*, 147 F. (2d) 255 (C. C. A. 8th); *Hubbell* v. *Commissioner*, 150 F. (2d) 516 (C. C. A. 6th); *Hackett* v. *Commissioner*, 159 F. (2d) 121 (C. C. A. 1st); *Ward* v. *Commissioner*, 159 F. (2d) 502 (C. C. A. 2d).

2. There is a Conflict Between the Decision Below and *Nelson* v. *Ferguson* (C. C. A. 3rd).

We do not follow the respondent's statement that there is no conflict between the decision of the Court of Appeals in this case and *Nelson* v. *Ferguson,* 56 F. (2d) 121 (C. C. A. 3rd) cert. den. 286 U. S. 565. The respondent states that "the right to receive royalties there did not represent compensation" (Br. 11). The respondent's position is inconsistent with the position taken by the Government in that case and with the theory on which that case was decided. In the *Nelson* case, the royalty payments were paid to the taxpayer's wife by his employer pursuant to a royalty contract which he had assigned to his wife; the Government argued that the case was "squarely ruled by" *Lucas* v. *Earl,* 281 U. S. 111, *supra,* (which involved the assignment of compensation); and the Court (as did the Tax Court in the instant case) distinguished the *Earl* case upon the ground that the royalties themselves were earnings from income-producing property, rather than compensation, saying (p. 125):

> "Here the income sprang from assigned property and, if validly assigned, the income was that of the assignee, the owner of the property and was taxable as hers."

CONCLUSION

It is accordingly submitted that this Court should issue a writ of certiorari to review the decision of the Court of Appeals in this case.

(1) The Court of Appeals has exceeded its power of appellate review, as clearly limited by decisions of this Court.

(2) The decision below is in conflict with a decision of the Third Circuit Court of Appeals on the same matter.

(3) This case presents an important question of Federal law which should be settled by this Court.

Respectfully submitted,

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November 3, 1948.

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v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 17-33) and the dissenting opinions (R. 33-37) are reported at 8 T.C. 1058. The opinion of the Court of Appeals (R. 62-69) is reported at 168 F. 2d 441.

JURISDICTION

The judgment of the Court of Appeals was entered on June 4, 1948 (R. 69-70). A petition for rehearing (R. 71-74) was denied on June 22,

1948 (R. 75-76). The petition for a writ of certiorari was filed on September 20, 1948. The jurisdiction of this Court is invoked under 28 U. S. C., Sec. 1254.

QUESTION PRESENTED

As compensation for services rendered the taxpayer acquired an "interest" in the Kodachrome process of manufacturing color film, which interest consisted only of the right to receive a percentage of the future royalties paid on the process. The question is whether the assignment by taxpayer to his wife in 1935 of his "interest" in the process operated to relieve him of liability for income tax on the royalties paid to his wife in the taxable years 1938 and 1939 pursuant to the assignment.

STATUTES INVOLVED

Revenue Act of 1938, c. 289, 52 Stat. 447:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * *

Section 22 (a) of the Internal Revenue Code (26 U. S. C. 22), which applies to the year 1939, is substantially the same.

STATEMENT

The facts were stipulated (R. 39-41) and were found by the Tax Court as stipulated (R. 18). The facts with respect to the issue presented in the petition for certiorari,[1] as stated by the Tax Court (R. 18-20), are substantially as follows:

By written assignment dated November 1, 1930, Leopold D. Mannes and Leopold Godowsky, Jr., the inventors of a process known as "Kodachrome", used in the manufacture of colored film, had assigned to Kuhn, Loeb & Company as trustees all the royalties payable by the Eastman Kodak Company to them under a license agreement and an option agreement of the same date,[2] except certain flat royalties payable directly to them as the inventors and which are not here in question. Thereafter the trustees paid the royalties to those entitled to receive them. (R. 18-19.)

Prior to 1935 the taxpayer rendered certain services to the New York and Foreign Development Corporation, a corporation formerly existing under

[1] The Court of Appeals decided a question with respect to the taxpayer's cost basis of common stock of Polaroid Corporation for purposes of determining the gain on the sale of such stock in 1938 (R. 64-69), but this holding is not involved in the petition for certiorari.

[2] The license and option agreements between them and Eastman Kodak Company were not annexed to the copy of their assignment, introduced in evidence in the Tax Court as Exhibit 3C of the Stipulation of Facts.

the laws of the State of New York, in connection with the financing of the Kodachrome process. For the rendition of the services, the taxpayer became entitled to receive a certain percentage of the royalties on the process. (R. 18.)

It was alleged in the petition and admitted in the answer in the Tax Court that "In 1935 the petitioner was the owner of an interest in the Kodachrome process of manufacturing color film". (R. 19.)

On December 20, 1935, the taxpayer delivered a letter to his wife, stating that he had, that day, assigned and transferred to her as a gift absolutely and irrevocably all his "right, title and interest in Kodachrome, manufactured by the Eastman Kodak Company." On December 20, 1935, he notified the trustees in writing of the assignment of royalties to his wife. (R. 19-20.)

During 1938 taxpayer's wife received from the trustees, pursuant to the assignment, $10,209.50 in royalties paid upon the Kodachrome process and during 1939 she received $14,183.94 in such royalties. All these royalties were paid for periods beginning after 1935. Taxpayer's wife included these amounts in her federal income tax returns for the years 1938 and 1939, respectively, and paid income tax thereon. She has timely filed protective claims for refund for those years in view of the Commissioner's position that the royalties are properly taxable to taxpayer. (R. 20.)

In determining the deficiencies here involved the Commissioner included the amounts of the royalties in taxpayer's income for the respective taxable years, explaining that such income "was received in payment for services rendered" by taxpayer. (R. 20.)

The Tax Court reversed this determination and held that the royalties paid to his wife in the taxable years were not taxpayer's income. (R. 27-31.) Judges Harron and Opper filed dissenting opinions (R. 33-37) and Judge Turner noted a general dissent (R. 33).

The Court of Appeals reversed the Tax Court. (R. 62-64.)

ARGUMENT

(1) Contrary to taxpayer's contention (Pet. 6; Br. 9-12), the Court of Appeals did not reject the so-called "finding" of the Tax Court that the taxpayer owned and assigned to his wife his "interest" in the Kodachrome process. It simply regarded the label attached by the Tax Court as not determinative and ascertained the real nature of what was assigned.[3] (R. 63-64.) This was the correct approach since the assignment of "property" does

[3] In contrast, the majority of the Tax Court did not deem it necessary to look beyond the label. (R. 28-31.) Compare the two dissenting opinions. (R. 33-37.) It is noted that, although the Commissioner's answer admitted that in 1935 the taxpayer owned an interest in the Kodachrome process (R. 6, 15), the pleadings did not define what rights this interest gave him. Moreover, the answer denied that taxpayer assigned his interest to his wife as alleged in paragraph (b) of the petition. (R. 6.)

not of itself determine that the income will not be taxable to the assignor. Indeed, the right to receive future income is a property right, but the assignment of such a property interest does not avoid the tax on the income. See *Helvering* v. *Horst,* 311 U. S. 112, 115, in which the Court expressly noted that a property right, the right to receive interim payments of interest, had there been transferred; *Helvering* v. *Eubank,* 311 U. S. 122; *Harrison* v. *Schaffner,* 312 U. S. 579, 582.[4]

The stipulated facts, which the Tax Court found as stipulated (R. 18), fully sustain the statements of the Court of Appeals (R. 63-64) that the taxpayer's interest consisted of only the right to receive a percentage of the royalties as they became payable, and that he did not receive any part of the Kodachrome process itself or any right to control its disposition. The stipulation shows that for financing services rendered in connection with the Kodachrome process prior to 1935, taxpayer became entitled "to receive a certain percentage of

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[4] Nor is the assignment of a property right determinative of the issue where the donor's retained rights or powers are such that he should be treated as in substance the owner of the property or the income. *Helvering* v. *Clifford,* 309 U. S. 331; *Commissioner* v. *Sunnen,* 333 U. S. 591. Moreover, where "property" which would constitute income to the assignor as it is *pro tanto* liquidated by payment is assigned, the assignor remains taxable on the payments received by the assignee. *Commissioner* v. *First State Bank,* 168 F. 2d 1004 (C.C.A. 5th), pending on petition for writ of certiorari, No. 285, this Term; *Richards' Estate* v. *Commissioner,* 150 F. 2d 837 (C.C.A. 2d); *Doyle* v. *Commissioner,* 147 F. 2d 769 (C.C.A. 4th).

the royalties" on the process.[5] (R. 40.) In 1935 he assigned to his wife "the right to receive the royalties" as the stipulation states (R. 40), in a letter which in terms assigned his "interest" in Kodachrome (R. 20). On the same date taxpayer notified Kuhn, Loeb and Company, the trustees, who in 1930 had received from the inventors of the process an assignment of *the royalties payable* under the license granted to Eastman Kodak Company, of his assignment of royalties to his wife. (R. 40.) It is thus clear that the right to receive a percentage of the royalties distributable under the trust arrangement with Kuhn, Loeb and Company, which itself had no rights in the process other than to receive royalties, was the measure of taxpayer's interest in the process and that this right only was what was assigned to his wife. In this connection it is significant that the Tax Court did not find that the taxpayer had any rights in, or control over, the process, other than the right to share in the future royalties.

The taxpayer now suggests (Br. 13) that if the nature of his interest in the process were regarded as relevant, the Court of Appeals should have remanded the case to the Tax Court for findings on the point. This contention ignores the fact that the

[5] Since taxpayer had the right to receive only a *percentage* of the royalties payable on the process, there is no merit to the taxpayer's argument (Br. 12) that on the record he was the *only person* who had an interest in the process. The royalties in excess of taxpayer's percentage necessarily were payable to, or were owned by, another or others.

Tax Court found the facts as stipulated and that the stipulated facts show that taxpayer's interest consisted only of the right to receive royalties. The stipulation is plainly conclusive upon the taxpayer, who as the moving party had the burden to show of what his interest in the process consisted. Neither *Helvering* v. *Taylor,* 293 U.S. 507, nor *Helvering* v. *Rankin,* 295 U.S. 123, is pertinent here, since the Commissioner did not make an arbitrary and excessive determination of a deficiency and the Court of Appeals did not substitute a finding of its own in place of the stipulated facts which were adopted by the Tax Court.

(2) The Court of Appeals decided this case in accordance with the controlling decisions of this Court. The rule has long been clear that under Section 22(a) of the Revenue Act of 1938 and the Internal Revenue Code, *supra,* which defines gross income as including income derived from compensation for personal service of whatever kind and in whatever form paid, personal earnings are taxable to the one who earns them; in the case of earnings the services produce the income and in consequence the tax cannot be deflected to another by means of any kind of anticipatory arrangement, even though the assignment purports to transfer a "property interest". *Lucas* v. *Earl,* 281 U.S. 111; *Burnet* v. *Leininger,* 285 U.S. 136; *Helvering* v. *Eubank,* 311 U.S. 122; *Commissioner* v. *Harmon,* 323 U.S. 44, rehearing denied, 323 U.S. 817; *Commissioner*

v. *Tower,* 327 U.S. 280, 289. See also *Helvering* v. *Horst,* 311 U.S. 112, 119; *Blair* v. *Commissioner,* 300 U.S. 5, 11; *Commissioner* v. *Sunnen,* 333 U.S. 591, 604; Paul, Federal Estate and Gift Taxation (1946 Supp.), Sec. 16.12, pp. 702-704. The decision of the Court of Appeals correctly applied that rule here.

This case is in all material respects similar to *Helvering* v. *Eubank, supra,* as the Court of Appeals held. (R. 64.) There in one instance Eubank assigned *all of his interest in a contract* under which he was entitled to receive, for his former services as agent, renewal commissions on insurance policies originally written by him. Despite the formal transfer of his property interest in the contract, this Court treated it, like the other assignment there involved, as in substance a transfer of the right to receive income, pointing out that the only purpose appeared to be to confer on the assignees the power to collect the commissions. So in the present case the taxpayer's assignment of his right to receive future royalties, acquired as compensation for personal services rendered in the past (see Stip., par. 2, R. 40), although referred to as an "interest" in Kodachrome, was in point of substance a transfer only of the right to receive personal earnings payable in the future, on which he remains taxable. Here, as in the *Eubank* case, the obvious purpose of the assignment was to confer

upon his wife the right to receive the future royalties.

The present case is not outside the scope of the *Eubank* case, as taxpayer argues (Br. 15-18), because the royalties were paid by a third person rather than by the taxpayer's employer. The taxpayer derived his right to receive the royalties from his employer as compensation for services, as stipulated (R. 40), and the royalties represented his earnings regardless of who actually paid them. Nor is the *Eubank* case distinguishable on the technical ground that taxpayer's compensation consisted of the acquisition of a property interest in the process rather than of the royalties themselves. Although the majority of the Tax Court took this view (R. 31), the stipulation which the Tax Court adopted (R. 18) stated plainly (R. 40) that the right to receive future royalties was the compensation for taxpayer's services. Moreover, taxpayer did not show that his interest in Kodachrome conferred upon him any right which would remunerate him, apart from the royalties he would receive. Quite obviously the parties contemplated that the taxpayer would derive his compensation from the future royalties he was entitled to receive, in lieu of direct payments by his employer. Cf. *Commissioner* v. *Smith,* 324 U.S. 177, rehearing denied, 324 U.S. 695. As *Helvering* v. *Horst,* 311 U.S. 112, 115-118, explains, a taxpayer on the cash receipts basis, who acquires a right to receive in-

come, is not taxed at the time his right to receive accrued, but instead is taxed when he receives the income or when it is paid to his donee pursuant to his previous assignment. Cf. *Perry* v. *Commissioner*, 152 F. 2d 183 (C.C.A. 8th).

Taxpayer's assertion (Pet. 7; Br. 18) that the judgment in this case conflicts with *Blair* v. *Commissioner*, 300 U.S. 5 is incorrect. That case did not involve the assignment of the right to receive recurring payments which represented compensation for personal services.[6] The *Blair* opinion specifically pointed out (p. 11)—"The tax here is not upon earnings which are taxed to the one who earns them." For the same reason there is no conflict with *Nelson* v. *Ferguson*, 56 F. 2d 121 (C.C.A. 3d), certiorari denied, 286 U. S. 565 (see Pet. 7; Br. 14); the right to receive royalties there did not represent compensation.[7]

(3) The taxpayer's contention (Pet. 7; Br. 19) that the decision of the Court of Appeals leaves the

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[6] This is not to say that the taxpayer in this case would escape the tax if his right to receive royalties had not been received as compensation for services. *Harrison* v. *Schaffner*, 312 U.S. 579, which limits the scope of the *Blair* case, indicates (p. 582) that even where the income is not personal earnings an assignor does not avoid the tax by attempting to disguise the transaction as a transfer of property rather than a transfer of income where that is its obvious purpose and effect.

[7] In the *Nelson* case the taxpayer transferred (without right to sell) to his employer a patent for exploitation in consideration of the payment of royalties, reserving the power to terminate the contract and reacquire the patent if the royalties fell below a certain amount or if the employer discontinued his employment. Nelson assigned the right to receive the royalties to his wife. Taking into consideration what was

position of persons who assign the right to receive payments constituting compensation in doubt is unwarranted. On the contrary the decisions of this Court, previously cited, established the rule that one who personally earns income is taxable on his earnings even though they have been assigned in advance of payment to another. Because of these decisions, the question in this case can hardly be described as unsettled. Nor does the decision have a "drastic effect" (Br. 19) because the earner cannot himself receive or obtain the income after it has been assigned. That has been true in most of the cases decided by this Court. But cf. *Commissioner* v. *Sunnen,* 333 U.S. 591. As *Helvering* v. *Horst,* 311 U.S. 112, 116-117, explains, the taxpayer who assigns income in advance of its payment has realized and enjoyed the income by exercising his power to procure its payment to another, equally as if he had collected it himself. See also *Harrison* v. *Schaffner,* 312 U. S. 579, 582.

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assigned and the rights reserved by Nelson, we believe the decision is unsound in the light of subsequent decisions by this Court. *Helvering* v. *Horst, supra; Harrison v. Schaffner, supra; Commissioner* v. *Sunnen,* 333 U.S. 591.

CONCLUSION

The judgment below is correct under controlling decisions of this Court and does not conflict with any decision. The petition for a writ of certiorari should therefore be denied.

Respectfully submitted,

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OCTOBER, 1948.

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Respondent.

No. 288

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR REHEARING

To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

Now comes your petitioner, Lewis L. Strauss, and in accordance with Rule 33, paragraph 2, of the Rules of this Court, presents this, his petition for a rehearing of the order of this Court denying the petition for a writ of certiorari to the United States Court of Appeals for the Second Circuit.

The petition for certiorari was filed on September 20, 1948, and a reply brief in support of such petition was filed on November 4, 1948. This Court denied the petition for such a writ of certiorari on November 8, 1948.

This petition for rehearing is based upon the intervening circumstance that the United States Court of Appeals for the Fifth Circuit on October 30, 1948, rendered a decision in *Farkas* v. *Commissioner* which is in conflict with the decision of the United States Court of Appeals for the Second Circuit in the instant case. The opinions in the *Farkas* case have not yet been officially reported and copies of those opinions were not received by petitioner's counsel in the ordinary course until after November 8, 1948, the date upon which this Court denied the petition for certiorari in the instant case. The opinions in the *Farkas* case are unofficially reported under date of November 10, 1948, in the Commerce Clearing House Standard Federal Tax Reporter at paragraph 9394 and under date of November 11, 1948, in the Prentice-Hall Federal Tax Service at paragraph 72,619. For the convenience of this Court, those opinions are reproduced in Appendix A attached hereto.

The question in both the instant case and the *Farkas* case was whether a taxpayer had (1) transferred "income-producing property" or (2) merely transferred a right to receive future income. As stated by the Court of Appeals for the Second Circuit in the instant case, the question was whether "the taxpayer had assigned property to his wife who received the payments from the trustee as income from that property * * *" (R. 63). The Court held that there had merely been an anticipatory assignment of income. The problem is similarly stated by the Court in the *Farkas* case in referring to the Commissioner's "theory that petitioner did not transfer income-producing property, but that the transfer was merely an assignment of the right of the taxpayer to receive income * * *". The Court held that income-producing property had been transferred and hence that the assignee, not the assignor, was taxable on the income. In the instant case, under similar circumstances the

assignor was held to be taxable on the income. Both Courts reversed a decision of the Tax Court, which is further evidence that this field of the law is in confusion.

Both the instant case and the *Farkas* case involved the assignment of an interest under a trust. In the instant case, the trust was one of which Kuhn, Loeb & Co. were trustees; in the *Farkas* case, the trust was a testamentary trust created by the taxpayer's father's will. In the instant case, the assignment was of the petitioner's entire rights under the trust; in the *Farkas* case, the assignment was of the taxpayer's entire rights under the trust for a maximum period of ten years.

The assignment of the petitioner in the instant case read as follows:

> "This is to evidence that I have, as of today, assigned and transferred over to you, absolutely and irrevocably all my right, title and interest in Kodachrome, manufactured by the Eastman Kodak Company. I am sending a copy of this letter to Kuhn, Loeb & Co. [the trustees] for their records. * * *"

The assignment in the *Farkas* case contained the following language:

> "For, and in consideration of One Dollar, I hereby transfer, assign and convey all my right, title and interest to the profits, dividends or income from the Estate of Sam Farkas as provided by the Will of Sam Farkas to be paid to each heir, to my brother Mack Farkas, in trust. * * *"

In both the instant case and the *Farkas* case, the taxpayer's interest in the trust was admittedly a property right, even though in both cases the Courts of Appeal held that

the assigned property right consisted only of a right to receive income from the trust.

The Court of Appeals for the Second Circuit in the instant case held that the petitioner was taxable upon the income from the trust even after he had assigned his entire interest in that trust income to his wife. On the contrary, the Court of Appeals for the Fifth Circuit (Judge McCord dissenting) held that the taxpayer was not taxable after assigning to his relatives his interest in the income of a trust for a maximum period of ten years.

In the instant case, it is admitted that the petitioner received his property interest (which, under the theory of the Court of Appeals for the Second Circuit, was merely a right to receive royalties from the trustees) as compensation for services. In the *Farkas* case, the taxpayer was entitled to receive the "profits, dividends or income" from the trust because of a bequest from his father. In each case, the question was the vexing one of what is the proper distinction between a disposition of income-producing property and a mere anticipatory assignment of future income. In each case, had it been determined that the taxpayer assigned income-producing property, the assignee rather than the taxpayer would have been held to be taxable on the income from such property. Similarly, in each case, had the assignment been held to effect a mere anticipatory assignment of future income, the taxpayer would have been held taxable thereon.

We have been unable to find any decision indicating that the way in which the taxpayer received income-producing property has any effect whatsoever upon the taxability of the income from that property after it has been assigned by the taxpayer. For example, whether a taxpayer received

shares of stock as compensation or by bequest, he would not be taxable upon the dividends if he assigned the stock to someone else. To the contrary, he would continue to be taxable on the dividends regardless of how he acquired the stock if he merely made an anticipatory assignment of the dividend income. So in the instant case, the fact that the petitioner received his interest in the trust as compensation and the fact that the taxpayer in the *Farkas* case received his trust interest by bequest does not keep the basic issue in each case from being the same. As stated by both the Court of Appeals for the Second Circuit and the Court of Appeals for the Fifth Circuit, the basic issue was whether by assignment of the interest in the trust the taxpayer had assigned income-producing property or merely made an anticipatory assignment of future income. The two Courts reached conflicting decisions on that basic issue.

It is respectfully submitted that in view of the conflicting decisions of the Courts of Appeals upon this matter, this Court should grant the petition for certiorari in the instant case in order that there may be an authoritative decision of this Court upon a troublesome question which is of great importance in the administration of the internal revenue laws. Should the Commissioner of Internal Revenue apply for certiorari in the *Farkas* case, this Court might wish to set the two cases for argument at the same time.

Respectfully submitted,

ROSWELL MAGILL,
Counsel for Petitioner,
15 Broad Street,
New York 5, N. Y.

GEORGE G. TYLER,
Of Counsel.

CERTIFICATE OF COUNSEL

I, Roswell Magill, counsel for the above-named petitioner, do hereby certify that the foregoing petition for rehearing is presented in good faith and not for delay, and that such petition is restricted to the grounds specified in Rule 33, paragraph 2, of the Rules of this Court.

ROSWELL MAGILL

November 16, 1948.

APPENDIX A

Leonard Farkas, Petitioner v. *Commissioner of Internal Revenue, Respondent.*

In the United States Court of Appeals for the Fifth Circuit. No. 12231. October 30, 1948.

Petition for Review of Decision of the Tax Court of the United States (District of Georgia).

Joseph B. Brennan, Elbert P. Tuttle, Norman Stallings, Atlanta, Ga., and Leonard Farkas, Albany, Ga., for the petitioner. Melva M. Graney, George A. Stinson, Ellis N. Slack and Helen Goodner, Special Assistants to the Attorney General, Theron L. Caudle, Assistant Attorney General, Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, and John W. Smith, Special Attorney, Bureau of Internal Revenue, all of Washington, D. C., for the respondent.

Before HUTCHESON, MCCORD, and WALLER, Circuit Judges.

WALLER, Circuit Judge: The undisputed facts in this case were succinctly stated by The Tax Court.[1]

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[1] Petitioner is a lawyer residing in Albany, Georgia. Petitioner is unmarried and one of eight children of Sam Farkas who died testate in 1915.

By will, petitioner's father set up a testamentary trust, under the terms of which the income was to be paid to the testator's eight children for life. The will provided that the trust was to continue during the life of the eight children and until the testator's youngest grandchild attained the age of 21 years, at which time the trust was to terminate and the estate was to be divided among the direct descendants of the testator *per stirpes*.

Item 18 of the will provided that if any of the children should attempt to divest themselves of the beneficial interest to which they were entitled, such child would forfeit his right in the estate and his interest would terminate and be divided among the remaining heirs.

Five of the eight children, including petitioner, were appointed trustees of the testamentary trust and also executors under the will of the decedent.

The Commissioner determined that the petitioner was taxable on the entire ⅛ share of the income from his father's testamentary trust notwithstanding the assignment and transfer of the entire interest of the taxpayer of all the income, profits, and dividends therefrom during the existence of the trust, on the theory that petitioner did not transfer income-producing property, but that the trans-

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The testamentary trust established under the will of petitioner's father continued in existence throughout the taxable year 1943.

In 1943 petitioner was 53 years old and was worth about $500,000. His closest relatives were his brothers and sisters.

On January 8, 1943, petitioner executed the following trust instrument:

"For, and in consideration of One Dollar, I hereby transfer, assign and convey all my right, title and interest to the profits, dividends or income from the Estate of Sam Farkas as provided by the Will of Sam Farkas to be paid to each heir, to my brother Mack Farkas, in trust. This trust to terminate within ten years from the date hereof, or upon the death of Mack Farkas.

"The income from said Estate is to be used by my brother Mack Farkas to aid any of my brothers or sisters in educating their children, or in sickness or financial reverses, or extraordinary needs. I leave it entirely to my brother Mack Farkas, Trustee, to determine the amount and to whom he shall make gifts, giving him absolute discretion in the matter, and giving him authority to dispose of all the income hereby conveyed, or any part thereof just as he sees fit, provided no portion of which shall go to the undersigned.

"At the termination of this trust whatever amount that may have been accumulated by said Trustee from the interest hereby conveyed may be disposed of by him, if living, as he sees fit, or by Will, whether for the use or benefit of my brothers and sisters, or not, making him the sole arbiter to determine how and in what way he shall dispose of same, provided no portion of which shall go to the undersigned."

Mack Farkas, the trustee, was 58 years old in 1943 and had a life expectancy under the American Experience Table of Mortality of 15.39 years.

Petitioner filed a gift tax return for 1943 in which he reported a gift of his one-eighth interest in the estate of Sam Farkas at a value of $26,473.59.

fer was merely an assignment of the right of the taxpayer to receive income for such limited period and was merely an anticipatory assignment of future income and taxable to the donor, as such, under the decisions in *Harrison* v. *Schaffner*, 312 U. S. 579, and *Helvering* v. *Horst*, 311 U. S. 112. The Tax Court, with four judges dissenting, sustained the Commissioner.

The testamentary trust created by petitioner's father reported its income on the basis of a fiscal year ended April 30. Petitioner reported his income on the calendar year basis.

A one-eighth share of the income of the testamentary trust distributable to petitioner in 1943 was $7,791.79. Since petitioner set up the *inter vivos* trust within the fiscal year of the testamentary trust, the sum of $5,400.88 was paid to petitioner and the balance of $2,390.91 was paid to Mack Farkas, trustee of the *inter vivos* trust.

Petitioner reported the $5,400.88 in his individual income tax return for 1943. The return disclosed net taxable income of approximately $40,300.

Mack Farkas, trustee of the *inter vivos* trust, reported the $2,390.91 received from the testamentary trust in a fiduciary return which disclosed distributions to eleven beneficiaries in the total amount of $1,822.52.

In September 1945 Mack Farkas, trustee under the *inter vivos* trust, instituted a friendly suit in the Superior Court of Georgia against the beneficiaries of the testamentary trust set up by petitioner's father to determine the validity of the *inter vivos* trust created by petitioner on January 8, 1943, in light of Item 18 of the testator's will prohibiting a beneficiary from transferring his interest under the testamentary trust and providing that such an attempted transfer should forfeit the right of the beneficiary in the estate. Decision was finally rendered on July 2, 1946, by the Supreme Court of Georgia in *Farkas* v. *Farkas*, 38 S. E. (2d) 924, holding that the trust deed executed by petitioner on January 8, 1943, did not forfeit petitioner's interest in the testamentary trust set up by his father, and that Mack Farkas, trustee under the *inter vivos* trust created by petitioner, was entitled to petitioner's share of the income of the testamentary trust.

Respondent determined that the full amount of $7,791.79 distributable by the testamentary trust to petitioner in 1943 was taxable to petitioner and increased the amount of income reported by petitioner for 1943 by the $2,390.91 reported by Mack Farkas, trustee of the *inter vivos* trust.

The petitioner insists that he conveyed to the trust an equitable interest in the testamentary trust of his father, and that such equitable interest so conveyed was substantial in that it carried with it all the right, title, and interest in and to profits, dividends, or income, for a ten-year period, which he, the petitioner, had in the testamentary trust, and was, therefore, not merely an anticipatory assignment of future income.

The rights so assigned by the taxpayer were co-extensive with the rights that he held under the trust of his father, with the exception that his interest in his father's trust would not terminate upon the death of Mack Farkas, the trustee of the *inter vivos* trust, but only upon the death of the taxpayer, or when the youngest grandchild of Sam Farkas should attain his majority.

No right to control, or to revoke, the trust or to receive the income therefrom was retained in the settlor, such as provoked the doctrine announced in *Helvering* v. *Clifford*, 309 U. S. 331, and similar cases. The fact that the thing assigned could revert to the settlor upon the death of the trustee, standing alone, would not, in our opinion, render the income from the trust taxable to the settlor. We know of no case holding otherwise.

In the absence of the power to command or to enjoy the income or any benefits therefrom left in the settlor, and in the absence of any finding on the part of The Tax Court —or in the absence of any evidence to support a finding— that the transfer was but a sham or a shadow having no substance, whereby taxpayer sought to evade taxes on income that in reality belonged to him, it is essential for us to decide whether the transfer in question was of an equitable interest in a trust estate as defined and adjudged in *Blair* v. *Commissioner*, 300 U. S. 5, and not merely an anticipatory assignment of future income as that term was expanded and defined in *Helvering* v. *Horst*, *supra*, and *Helvering* v. *Eubank*, 311 U. S. 122, and, if so, to what

extent, if any, this case is ruled by the pronouncement in *Harrison* v. *Schaffner, supra,* that a gift by a life beneficiary of a right to receive a specified amount of income for the period of one year from the trust was an anticipatory assignment of future income, and not a transfer of a substantial equitable interest in the trust estate.

Whether the interest in the testamentary trust that the taxpayer assigned was an equitable interest in property is hardly an open question here. The Supreme Court in the *Blair* case, *supra,* and the Supreme Court of Georgia, in *Farkas* v. *Farkas,* 38 S. E. (2d) 924, as well as The Tax Court in this case, have each considered such a transfer to have been of an equitable interest in the trust estate. Counsel for the Commissioner likewise deems the assignment to have been of such an interest.

The holding in the *Blair* case, *supra,* to the effect that such an assignment is of an equitable interest in the trust estate, and that the income should follow the property, is controlling, unless *Helvering* v. *Clifford* or *Harrison* v. *Schaffner, supra,* has nullified such holding in the *Blair* case. As we view it, the *Clifford* and *Schaffner* cases have not rejected the concept that such a transfer is of an equitable interest, but those cases have made it clear that such a disposition of such property must be substantial and not merely colorable, and that when a transfer retains in the transferor the characteristics of ownership, or is only for a day, a month, or a year, it will be regarded as if no disposition had been made at all. The test here, therefore, is whether or not the transfer, which: (a) could run for approximately ten years, or until the death of the trustee, or for a considerable portion of the life expectancy of the donor; (b) was irrevocable by the settlor; (c) prohibited the settlor from obtaining any of the income or accumulations thereof; (d) gave the trustee absolute direction and control of the disposition of the income among the beneficiaries; (e) in no wise relieved the settlor of any duty of support of members of his family; and (f) retained in

settlor no characteristics of ownership; was substantial within the contemplation of the *Schaffner* case.[2]

We conclude that since: (a) the decisions and admissions show that the interest transferred was an equitable interest in the testamentary trust estate; (b) there was a complete renunciation by the settlor of any benefit or control to the property; (c) the trust was not one of an unreasonably short duration but was for a large portion of settlor's life expectancy; we should hold that the transfer was a substantial disposition of property and not merely the anticipatory assignment of future income. See *C. I. R.* v. *Jonas*, 122 Fed. (2d) 169, and *U. S.* v. *Pierce*, 137 Fed. (2d) 428.

The decision of The Tax Court is

REVERSED.

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[2]In *Harrison* v. *Schaffner*, the Court, speaking through Mr. Justice Stone, said:

> "Nor are we troubled by the logical difficulties of drawing the line between a gift of an equitable interest in property for life effected by a gift for life of a share of the income of the trust and the gift of the income or a part of it for the period of a year as in this case. 'Drawing the line' is a recurrent difficulty in those fields of the law where differences in degree produce ultimate differences in kind. See *Irwin* v. *Gavit*, 268 U. S. 161, 168. It is enough that we find in the present case that the taxpayer, in point of substance, has parted with no substantial interest in property other than the specified payments of income which, like other gifts of income, are taxable to the donor. Unless in the meantime the difficulty be resolved by statute or treasury regulation, we leave it to future judicial decisions to determine precisely where the line shall be drawn between gifts of income-producing property and gifts of income from property of which the donor remains the owner, for all substantial and practical purposes."

HUTCHESON, C. J., concurring: To the reasons given in the majority opinion for reversing the decision of the Tax Court, I add one other. This is that, though Treasury Regulations 111, Sec. 2922 as added by *T. D. 5488* and *5567*, apply authoritatively only to years beginning after Dec. 31, 1945, and are, therefore, not controlling here but merely informative, they furnish, I think, conclusive support to the "judicial determination" we have made that the income from the assigned trust interest is not taxable to the grantor. They do this by fixing for the future the line within which, though assigned, trust income is taxable to the grantor as substantial owner thereof at within ten years "commencing with the date of the transfer," thus extending protection to assignments, the duration of which is almost, if not quite, identical with that of the assignment in this case. This is so equally whether, as contended by petitioner, the period fixed in the assignment falls within, or as contended by the Commissioner, just without the protection of the regulation.

In *Harrison* v. *Schaffner*, 312 U. S. 579, the Supreme Court declared, at page 582:

> "We think that the gift by a beneficiary of a trust of some part of the income derived from the trust property for the period of a day, a month or a year involves no such substantial disposition of the trust property as to camouflage the reality that he is enjoying the benefit of the income from the trust of which he continues to be the beneficiary, quite as much as he enjoys the benefits of interest or wages which he gives away as in the *Horst* and *Eubank* cases."

but it went on to say:

> "Nor are we troubled by the logical difficulties of drawing the line between a gift of an equitable inter-

> est in property for life effected by a gift for life of a share of the income of the trust and the gift of the income or *a part of it for the period of a year as in this case.* 'Drawing the line' is a recurrent difficulty in those fields of the law where differences in degree produce ultimate differences in kind. See *Irwin* v. *Gavit,* 268 U. S. 161, 168. It is enough that we find in the present case that the taxpayer, in point of substance, has parted with no substantial interest in property other than the specified payments of income which, like other gifts of income, are taxable to the donor. *Unless in the meantime the difficulty be resolved by statute or treasury regulation, we leave it to future judicial decisions to determine precisely where the line shall be drawn between gifts of income-producing property and gifts of income from property of which the donor remains the owner, for all substantial and practical purposes."* (Italics supplied.)

Following the suggestion in that decision, the Treasury has drawn the line of unsubstantiality for the future as within ten years. Assuming that the regulation is valid and controlling, how can it reasonably be said that an assignment, which at worst for petitioner falls just within the line so fixed, is an unsubstantial assignment. It must be remembered that Treasury regulations are not arbitrary fiats, but are valid only when they neither add to nor subtract from the statute. It must be remembered, too, that we are admonished by the Supreme Court that, until the difficulty of drawing the line is "resolved by statute or Treasury regulation," it must be left "to future judicial decision to determine precisely where the line shall be drawn." With these remembrances in mind, it must, we think, be said of a judicial determination, made before the regulations take effect, that the assignment in this case is not substantial, would be drawing far too fine a bead, would, in short, be to unreason-

ably attribute to administration a keenness of perception denied to judging.

McCord, Circuit Judge, dissenting: I have no quarrel with my learned brothers as to the principles of law applicable to this case. I just cannot bring myself to agree with their holding that petitioner, through the medium of the ten year *inter vivos* trust for the benefit of his relatives, has parted with a substantial interest in the trust corpus which precludes the application of the rule announced in *Harrison* v. *Schaffner,* 312 U. S. 579. I do not view the transfer in question as a substantial disposition of the trust property, but consider it a mere anticipatory assignment of future income, taxable to the donor. *Helvering* v. *Horst,* 311 U. S. 112; *Blair* v. *Commissioner,* 300 U. S. 5; *Harrison* v. *Schaffner,* 312 U. S. 579. The majority opinion limits too strictly the principles enunciated in the *Blair* and *Schaffner* cases. The *Schaffner* and similar cases clearly established that one is taxable upon income which he assigns, when he nevertheless retains a substantial interest in the income-producing property. Although the *Blair* case defines the right of a life beneficiary to receive income from the trust corpus as an equitable interest in the trust estate, it merely holds that where the donor transfers and irrevocably releases his full future interest in all or part of the trust income, he has thereby conveyed and assigned such equitable interest in the trust property. It does not hold that when the donor transfers substantially less than all of his future interest in the income assigned, he should not be taxed on the income therefrom. Here, petitioner did not assign all of his future interest in the testamentary trust income to the *inter vivos* trust, but retained his right to receive it again after a ten year period, or before ten years, in the event of the trustee's death during that time. The record clearly reveals, and the Tax Court found, that petitioner was a man of considerable financial means, and that at the time of the transfer he wanted to make a "gift" of the trust income to the other less fortunate members of his family

in a manner that would prevent him from being liable for income tax on the income assigned. Instead of retaining the income from the testamentary trust himself, and making outright gifts to them from it, with no strings attached, he chose the ingenious device of the ten year *inter vivos* trust, with federal income tax consequences in mind. Under such circumstances, I do not think we should view the present transfer as a substantial disposition of the trust property, merely because the transfer was presumably irrevocable for a ten year period. *Harrison* v. *Schaffner,* 312 U. S. 579.

I am well aware that it is not the function of courts, by judicial fiat, to attempt enactment of remedial tax legislation. I am further aware that every taxpayer has a constitutional privilege to minimize his tax liability through lawful tax avoidance. Nevertheless, I have never favored decisions which encourage loopholes in our tax laws and enable taxpayers, through the medium of ten year *inter vivos* trusts or otherwise, to transfer excess income and thereby retreat to lower tax brackets during prosperous and high tax years, and later to retrieve that same source of income in lean years, when income taxes are usually much lower.

I respectfully dissent.